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SUBJECT: CHINA'S AUTO INDUSTRY ENJOYS RECORD SALES FOR FOURTH
STRAIGHT MONTH, BOLSTERED BY AUTO SUPPORT PLAN

REF: (A) BEIJING 151; (B) SHANGHAI 96

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¶1. (SBU) SUMMARY. Record auto sales in April suggest that China's auto support plan is providing a significant boost to the industry. April auto sales data released by the China Association of Automobile Manufacturers (CAAM) show that 1.15 million vehicles were sold, the fourth straight month of record sales and a 25 percent increase YoY. Consumers are taking advantage of the sales tax cuts on smaller cars and rural subsidies that were first announced by the State Council January 14 and later detailed in the State Council's March 20 release of the Automotive Industry Readjustment and Revitalization Plan. The recent trend in increasing sales and decreasing exports reflects the growing influence and strength of the Chinese market in the global automobile industry. According to Embassy contacts, the short term result of the stimulus package makes China the fastest growing auto market, especially for low emission cars, but at the cost of lower profit margins. END SUMMARY.

## China Releases Detailed Auto Industry Support Plan

¶2. (SBU) The State Council released March 20 a detailed plan to support China's auto industry. The plan aims to bolster the domestic market through the use of subsidies, transform the auto industry through consolidation and technology upgrades, and make China a market leader in new-energy vehicles.

¶3. (SBU) Premier Wen Jiabao initially approved the auto industrial revitalization plan at the January 14 State Council meeting after auto sales had dipped to 6.7 percent in 2008, the first time in 10 years without double digit growth. The original announcement called for a proactive financial approach including a reduction in sales tax on vehicles with engines smaller than 1.6 liters from 10 percent to 5 percent. Miao Wei, Vice Minister of Industry and Information Technology and former president of Dongfeng Motor Corporation, recently said that MIIT would consider further reducing the sales tax if necessary to protect China's recovering auto industry. Subsidies include 5 billion RMB earmarked for farmers to upgrade their old vehicles and 10 billion RMB to be used for technological upgrades and alternative energy development.

## Latest Sales Data Shows China Remains a Hot Auto Market

¶4. (SBU) Sales data released by CAAM show that 3.832 million

vehicles were sold during the first four months of the year, up 17.9 percent YoY. Total production also increased 6.4 percent to 3.725 million units. China has even surpassed cars sold in the United States, leading some major auto companies to publically announce that China is the centerpiece of the global auto industry. The Shanghai Auto Show held in April highlighted China's growing clout in the worldwide auto industry, with more than 1,500 auto and auto parts companies participating.

¶5. (SBU) GM China Group, through its joint venture with SAIC Motor Corporation and Wuling Automobile, sees continued benefits from the sales tax cut and even plans to build another assembly plant to reach its announced target of doubling its current annual sales to more than two million vehicles in the next five years. GM also anticipates using China as an export base once the global market rebounds. Ford China also recognizes China as the main growth engine for autos as it plans to move its Asia-Pacific headquarters to China from Thailand.

¶6. (SBU) As stated in the plan, China's target for the next three years is a 10 percent annual average growth rate, with total sales to exceed 10 million units in 2009. Total sales in 2008 were 9.37 million, and several industry experts, including China Automotive Review's (CAR) Executive Managing Editor Alfred Tian, believe that the 10 million unit target is easily obtainable. A JP Morgan report states that China's low auto penetration rate of 32 vehicles per one thousand persons in 2008 shows that there is room to reach their forecasted 14 percent growth in 2009 and 12 percent growth for 2010.

But The Increase Comes At The Cost Of Lower Profit Margins
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¶7. (SBU) Not all analysts are so optimistic, however. China CAAM Assistant Secretary General Zhu Yiping said that the high sales numbers could contribute to China's GDP growth but at a cost to automakers whose income has dropped 9.42 percent YoY for January and February. While total income was 320.4 billion yuan, profit margins have decreased 59 percent to just 6.6 billion yuan. CAAM data shows that minivans accounted for 70.7 percent of sales in the first quarter. These vehicles cost around 50,000 yuan (approximately USD 7300) with a profit margin less than 1 percent. According to CAAM, profits of the top 19 auto manufacturing enterprise groups fell 46.4 percent in the first quarter YoY.

¶8. (SBU) Chinese Academy of Social Sciences (CASS) Institute of Industrial Economics Researcher Zhao Ying told EconOff that these sales targets were just numbers and that China was unlikely to reach its purported 10 percent annual growth based solely upon tax cuts and subsidies. Zhao said that the "vehicles to the countryside" plan, which allocates 5 billion yuan to subsidize farmers who trade in older vehicles for newer ones from March 1 to December 31, 2009, will only increase sales by 1 million units. Furthermore, these sales may just be pushed forward to take advantage of the financial incentive. The main purpose of the subsidies is to increase domestic demand, as Chinese companies exported only 61,000 vehicles, a drop of 62.1 percent YoY.

Government Procurement Provision Removed from Detailed Plan
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¶9. (SBU) The main difference between the January announcement of the auto industry revitalization plan and March release of the detailed plan was the removal of a provision that government procurement should be readjusted to prioritize the purchase of new energy, environmentally-friendly and independent-branded vehicles. Auto analyst Wayne Xing argued that this provision may have been taken out due to the unrealistic goal that independent-branded vehicles make up more than 50 percent of total purchases. The figure currently stands at 3-4 percent. Xing also speculated that China was concerned the provision may be in violation of the WTO rules on national treatment.

New Energy Vehicles a High Priority
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¶10. (SBU) While the plan has the desired short-term effect of increasing sales of more fuel-efficient vehicles with smaller engines, it also projects into the future with a specific New Energy Vehicle Strategy. The goal is to have annual production of all new-energy vehicles reach 500,000 units by 2011, with sales of these all-electric battery cars, plug-in hybrids, and hydrogen fuel-cell cars to be five percent of total auto sales. The plan also stipulates that all vehicle manufactures must have new energy products.

¶11. (SBU) The plan allocates 10 billion yuan in the next 3 years for technology upgrades including safety and alternative-energy. China is considering rebate offers to encourage domestic demand for new-energy vehicles. Pilot programs are being implemented to encourage the new-energy industry. A three-way partnership between Ministry of Industry and Information Technology, the Wuhan provincial government, and Nissan is underway to develop electric vehicles and an infrastructure of charging stations. Wuhan, Beijing, Shanghai, Chongqing are among the 13 cities to pilot programs that will collectively put 60,000 new-energy cars in service by 2013.

¶12. (SBU) CASS's Zhao was pessimistic about reaching the goal of 500,000 new-energy cars, citing a lack of infrastructure and key auto parts. He stated that the current subsidies were not enough to jump start the industry and that success would be contingent on market demand and public support.

Still Waiting for Restructuring and Consolidation
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¶13. (SBU) The plan calls specifically for eight companies to conduct mergers and acquisitions with the goal to form 2-3 large enterprise groups with annual production and sales of 2 million units and 4-5 smaller groups with sales exceeding 1 million units. The four large companies specifically cited to consider nationwide consolidation



include Shanghai Automotive Industry Corp (SAIC), China FAW Group Corp, DongFeng Auto, and Changan Auto. The companies encouraged to consolidate regionally include Beijing Automotive Industry Corp, Guangzhou Automotive Industry Corp, Chongqing Automotive Industry Corp, and Chery. CAR's Tian told EconOff that forced consolidation would not work and should be left to market demand. He cited SAIC's purchase of Nanjing Auto in 2007 as an example of forced consolidation that continues to encounter integration difficulties.

Comment
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¶14. (SBU) The plan's call for an increase of the domestic market share of globally-unique (independent) brands to over 40 percent will likely benefit Chinese companies that make their own brands such as Wuling, Changan Auto, and Chery. Although the plan's support for industry consolidation will no doubt help China's large state-owned carmakers, foreign carmakers with JVs such as GM China and private companies such as Geely Automobile Holdings and BYD Auto Company will remain real competitors. Geely has put in tenders for both Volvo and Saab as part of their plan to establish a presence overseas. BYD, during the single month of April, jumped from number 14 to number 7 for domestic auto sales.

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